

PART 1

Section 4945---Taxes on Taxable Expenditures

26 CFR 53.4945-4: Grants to individuals.
(Also §117; §1.117-1.)

Rev. Rul. 2003-32

ISSUE

If a private foundation awards educational grants to employees or children of employees of a particular employer who are victims of a qualified disaster as defined in §139 of the Internal Revenue Code, and the educational grants do not satisfy the percentage test of Rev. Proc. 76-47, 1976-2 C.B. 670, are these educational grants treated as scholarships subject to the provisions of §117 and not treated as taxable expenditures under §4945(d)(3)?

FACTS

The foundation is exempt from federal income tax under §501(c)(3) and is a private foundation under §509(a). The foundation has applied under §4945(g) for approval of its proposed scholarship program. The foundation intends to provide scholarships to employees or children of employees of a particular employer if the employee is seriously injured or killed as a result of a qualified disaster within the meaning of §139(c)(1), (2), or (3). The foundation will determine whether these criteria are satisfied using objective standards that are consistently applied.

Section 139(c) provides that the term "qualified disaster" includes (1) a disaster that results from a terroristic or military action (as defined in §692(c)), (2) a Presidentially declared disaster (as defined in §1033(h)(3)), or (3) a disaster that results from an accident involving a common carrier, or from any other event, which is determined by the Secretary to be of a catastrophic nature.

The group of employees or children of employees from whom grantees are selected is sufficiently broad to constitute a charitable class. The foundation's scholarship program will satisfy the requirements of §4945(g)(1) and the guidelines of §§4.01 through 4.07 of Rev. Proc. 76-47, 1976-2 C.B. 670; however, the foundation will award grants without regard to the percentage limitation test of §4.08 of Rev. Proc. 76-47. The foundation intends to make grants to all eligible applicants.

LAW AND ANALYSIS

A grant by a private foundation to an individual for travel, study, or other similar purposes is a taxable expenditure by the private foundation under §4945(d)(3) unless such grant satisfies the requirements of §4945(g). Such a grant, awarded on an objective and nondiscriminatory basis pursuant to a procedure approved in advance by the Secretary, may satisfy the requirements of §4945(g)(1) if it is demonstrated to the satisfaction of the Secretary that the grant (i) constitutes a scholarship or fellowship grant that is subject to the provisions of §117(a) as in effect on the day before the date of the enactment of the Tax Reform Act of 1986 and (ii) is to be used for study at an educational organization described in §170(b)(1)(A)(ii).

When an employer makes educational grants available to its employees on a preferential basis, the employer-employee relationship immediately suggests that the grant may be compensatory. To ensure that employer-related grant programs are outside the pattern of employment and, therefore, not compensatory, substantial factors not related to employment must control and limit grant programs to such an extent that the preferential treatment derived from employment does not continue to be of any significance beyond being an initial qualifier.

Rev. Proc. 76-47, 1976-2 C.B. 670, provides guidelines for determining whether a grant made by a private foundation under an employer-related grant program to an employee or to a child of an employee of the particular employer is a scholarship under §§117 and 4945(g)(1), rather than a form of compensation, an employment incentive, or an employee fringe benefit. The Service will assume that grants awarded under an employer-related grant program will be scholarships or fellowship grants under §§117 and 4945(g)(1) if the program satisfies the seven conditions in §§4.01 through 4.07 and the percentage test described in §4.08 of Rev. Proc. 76-47.

Rev. Proc. 76-47, 1976-2 C.B. 670, provides that if an employer-related private foundation's educational grant program satisfies the seven conditions of Rev. Proc. 76-47, §§4.01 through 4.07, but does not meet the percentage test of §4.08, then all the facts and circumstances will be reviewed in determining whether the primary purpose of the program is to provide extra compensation or another employment incentive, or whether the primary purpose is to educate recipients in their individual capacities.

For this program, employment is the initial, but not the sole, qualifier. An employee or the child of an employee is eligible for an educational grant only in the event the employee is seriously injured or killed as a result of a qualified disaster. These eligibility criteria provide sufficient assurance that the primary purpose of the grant is to educate recipients in their individual capacities, outside of any pattern of employment, rather than to compensate employees or provide

an employment fringe benefit. Therefore, this educational grant program is not required to satisfy the percentage test of §4.08 because its eligibility requirements meet the facts and circumstances test of Rev. Proc. 76-47.

HOLDING

Under the facts set forth above, grants awarded under the program satisfy the requirements of Rev. Proc. 76-47, 1976-2 C.B. 670, and constitute scholarships subject to the provisions of §117. Therefore, grants awarded under the program satisfy the requirements of §4945(g)(1) and will not be taxable expenditures under §4945(d)(3). This revenue ruling does not address the extent to which the grants meet the requirements of “qualified scholarships” that may be excluded from the gross income of recipients under §117(a). See Notice 87-31, 1987-1 C.B. 475, for further information relating to the exclusion of qualified scholarships from gross income.

APPLICATION

This ruling also applies to Revenue Procedure 80-39, 1980-2 C.B. 772, which provides parallel guidelines for determining whether educational loans made by a private foundation under an employer-related loan program will satisfy the requirements of §4945(g)(3) and will not be taxable expenditures under §4945(d)(3).

DRAFTING INFORMATION

The principal author of this revenue ruling is Janet E. Gitterman of the Exempt Organizations, Tax Exempt and Government Entities Division. For further information regarding this revenue ruling, contact Ms. Gitterman at (202) 283-9458 (not a toll-free call).